

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 – PLR-120645-06

Date:

October 18, 2006

Company:

Shareholders:

Properties:

State:

a:

b:

c:

d:

e:

f:

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g:h:i:k:m:

Dear _____ :

This letter responds to your letter dated March 10, 2006, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

Company was incorporated under the laws of State on a and elected under § 1362(a) to be an S corporation effective b. Company has accumulated earnings and profits.

Company owns, leases, and manages commercial real estate, consisting of retail and office space.

Through its full-time operations manager (a shareholder and licensed building contractor) and part-time maintenance supervisor (a shareholder and retired licensed general contractor), as well as independent contractors, Company provides various services in leasing and managing the Properties. These services include monthly inspections of tenant interiors for electrical, roofing, or plumbing problems; all maintenance and repairs as needed for exteriors and interiors of all buildings, including painting, roofing, electrical and air conditioning systems, plumbing, parking lot, curbing, and drainage; grounds maintenance; cleaning of sidewalks and parking lots; interior janitorial services for some tenants; maintenance of exterior signs, including cleaning, lighting, and required changes; approval and supervision of tenant space modifications; resolution of tenant complaints; and 24-hour on-call service for emergencies.

Company received or accrued approximately c in rents and paid or incurred approximately d in relevant expenses for e on the Properties. The comparable figures for f are g and h, respectively, and the figures for i are k and m, respectively.

LAW AND ANALYSIS

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) terminates whenever the corporation (I) has accumulated earnings and profits at the close of each of three consecutive tax years, and (II) has gross receipts for each of such tax years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(1) of the Income Tax Regulations provides that "rents" means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

CONCLUSION

Based solely on the facts and representations submitted, we conclude that the rents Company receives from the Properties are not passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the

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Code. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation. Further, the passive investment income rules of § 1362 are independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

MARY BETH COLLINS
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosures: copy for § 6110 purposes